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**ARIZONA ATTORNEY GENERAL**

November 27, 1985

Max Sullivan, Director  
Arizona State Retirement System  
3815 North Black Canyon Highway  
P. O. Box 33910  
Phoenix, Arizona 85067

Re: I85-124 (R85-147)

Dear Mr. Sullivan:

You have asked several questions relating to the definition of "compensation" used in A.R.S. § 38-781.01(5). Through December 31, 1983 the definition of compensation to be included in figuring a state retirement system participant's retirement benefits, provided:

5. "Compensation" means the amounts actually received by the participant for remuneration for employment from an employer on an hourly or salaried basis including any incentive compensation, overtime or other irregular payments.

A.R.S. § 38-781.01(5) was amended by Laws 1983, Ch. 293, § 1 effective January 1, 1984, to provide in part:

"Compensation" means the gross amount paid to a participant by an employer as salary or wages, including amounts which are subject to deferred compensation or tax shelter agreements, for services rendered to or for an employer, or which would have been paid to the participant except for the participant's election or a legal requirement that all or part of the gross amount be used for other purposes. Compensation does not include:

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(a) Lump sum payments, on termination of employment, for accumulated vacation or annual leave, sick leave, compensatory time or any other form of termination pay.

\* \* \*

(c) Payment, at the participant's option, in lieu of fringe benefits which are normally paid for or provided by the employer.

By Laws 1985, Ch. 294, § 3 the Legislature added the following definition in A.R.S. § 38-781.01(3)(b) of "average monthly compensation":

(b) Effective July 1, 1985, the monthly average of compensation during a period of thirty-six consecutive months during which a participant receives the highest compensation within the last one hundred twenty months of service during which he made retirement contributions as required by law. . . . The provisions of this subdivision apply only to participants whose participation in the plan was effective after December 31, 1983 or who agree in writing as a binding condition of eligibility for being granted the benefit advantages available under this subdivision to have their benefit computed on the basis of the definition of compensation.

We have rephrased your several questions in order to answer them as three general questions.

1. When applying the 1984 definition of compensation, how may payments on account of termination of employment be distinguished from other payments received during the last year of employment before retirement?

If the only reason an employee receives a particular payment is because he is terminating employment, then that payment is received on account of termination of employment and, if paid as a lump sum, must be excluded from compensation under the 1984 definition. Such payments, whether designated stability pay, continuing service pay, sick pay, payments for

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vacation or annual leave, for compensatory time, or any other form of pay that would not be received other than for the termination of employment, must be excluded from compensation under the 1984 definition. This exclusion rule would apply to payments received from one employer upon termination when the employee transfers to another employer participating in the state retirement system and also would apply to transfers between state agencies, whether or not there was a break in state service between the two agencies.<sup>1/</sup>

Conversely, payments not received on account of termination, such as special incentive performance awards or payments made in the nature of stability pay over a course of years of employment on a regular basis, would not be made on account of termination of employment and therefore would be included within the definition of compensation for the purpose of determining retirement benefits.

2. Are "lump sum" payments, which are on account of termination of employment and thereby excluded from compensation under the 1984 definition of compensation for retirement purposes, limited to payments received in a single sum, or would the concept include installment payments?

The Arizona courts, in other circumstances, have consistently held that installment payments of a sum certain for a limited period constitute a lump sum payment. See, e.g., Cummings v. Lockwood, 84 Ariz. 335, 337-338, 327 P.2d 1012, 1014-1015 (1958), and Lindsay v. Lindsay, 115 Ariz. 322, 325, 565 P.2d 199, 202 (App. 1977). Also, see Simonds v. New York State Teachers' Ret. System, 42 A.D.2d 470, 349 N.Y.S.2d 140 (1973), where the appellate division of the New York Supreme Court held that a teacher receiving retirement or termination benefits, though spread out over an entire year and not in the form of one "lump sum," still constituted "lump sum" termination pay that was excludable in determining the teacher's retirement benefits. We likewise conclude that a lump sum paid on account of termination of employment includes any sum paid in installments or as a single payment when paid as a result of retirement or termination of employment.

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<sup>1/</sup>Under subparagraph C of A.R.S. § 38-781.01(5), such a payment also could be in lieu of fringe benefits (e.g. accrued annual leave) normally paid for or provided by the employer.

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3. Finally, you asked whether the system is authorized to pay interest to a participant upon the return of contributions withheld from a payment that later is determined not to be compensation for benefit computation purposes.

No section of the retirement system statutes deals directly with your question. However, we think the Board's authority under A.R.S. § 38-743(C) and § 38-781.02<sup>2/</sup>, when read together with A.R.S. § 38-781.12 providing for crediting and paying interest on participant's contributions upon withdrawal of contributions, includes authority to pay interest on contributions returned to a participant upon a determination that a payment for which contributions were withheld is not compensation for retirement benefit calculations.

Sincerely,



BOB CORBIN  
Attorney General

BC:JGF:DR:lp

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<sup>2/</sup>A.R.S. § 38-743(C) authorizes the State Retirement System Board to:

1. Determine the rights, benefits or obligations of any person under this article and afford any person dissatisfied with such determination a hearing thereon.
2. Determine the amount, manner and time of payment of any benefits under this article.